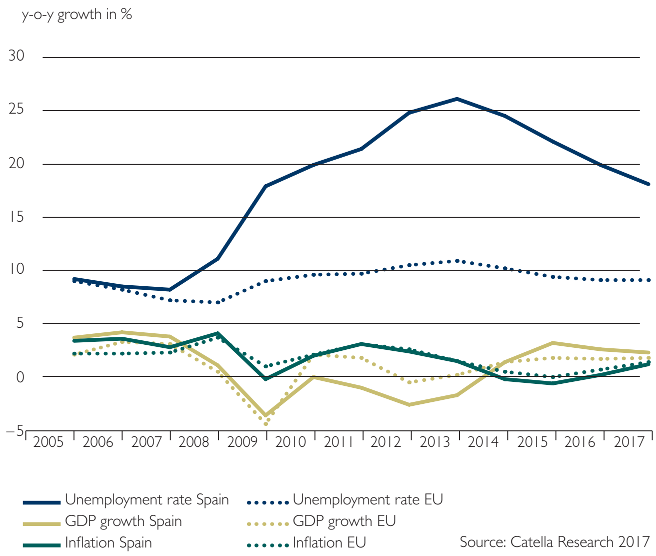
REAL ESTATE MARKET SPAIN – 2016/2017

Real Estate Market Spain – 2016/2017

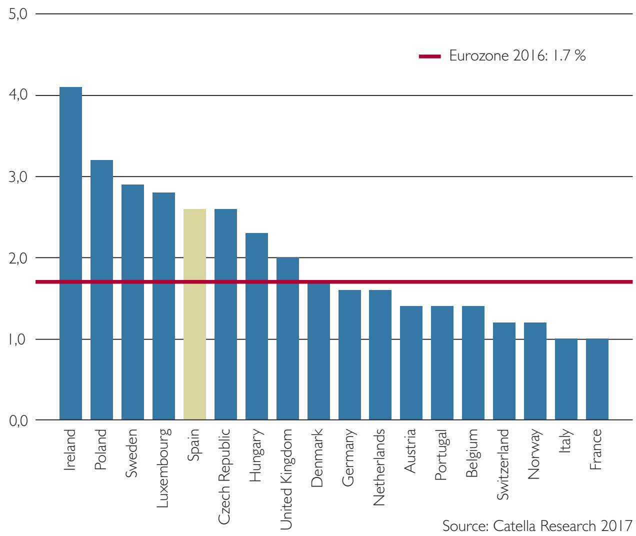
The fundamental data in Spain is positive and the economy is growing significantly over the European average. Looking at the property market, the investment volume decreased slightly in 2016 due to one factor: The lack of products on sale, simultaneous with the European property development. Our analysis provides an insight into the market as it currently stands and reveals what opportunities exist for investors

FIG. 1: MAIN ECONOMIC INDICATORS



Source: Catella Research 2017

FIG. 2: ECONOMIC GROWTH IN THE EUROZONE 2016



Source: Catella Research 2017

The Spanish economy is growing strongly, with all sectors of the economy making healthy contributions. Quarterly GDP growth averaged 0.8% in 2016. Although the domestic political environment has generated some uncertainty, economic activity has been largely unaffected. Consumer confidence remains high and is being supported by healthy employment growth, rising real disposable incomes and ultra-loose monetary policy.

The unemployment rate is declining, but remains high, at about 19 %. While falling, high long-term and youth unemployment pose particularly acute challenges. More effective active labour market policies and re-skilling are needed, along with a recovery in demand. Boosting living standards in the medium term hinges on increasing productivity via higher investment in innovation, strengthening skills and more intense competition.

After the significant easing of fiscal policy in 2015 and 2016, the fiscal stance will provide modest support over the projection period. With public debt around 100 % of GDP and the deficit still at slightly below 5 % of GDP, the scope for fiscal expansion is limited. It is nevertheless important to stimulate growth by shifting spending towards growth-enhancing outlays, such as education, active labour market policies, which are all below those in peer countries after having fallen substantially since the crisis. The structure of taxation remains tilted towards labour income which penalises growth and employment, and the tax burden should be shifted towards consumption and environmental taxes.

TAB. 1: ECONOMIC FUNDAMENTALS IN SPAIN (%)

	2013	2014	2015	2016	2017E
GDP growth	– 1.7	1.4	3.2	3.3	2.5
Consumer spending	– 2.3	2.4	3.4	3.3	2.3
Unemployment rate	26.1	24.4	22.1	19.9	18.1
Inflation	0.3	–1.0	0.0	1.6	1.6
Interest rate 3 month	0.3	0.1	–0.1	0.0	0.0
Interest rate 10 years	4.1	1.6	2.0	1.3	1.4

Source: Catella Research 2017

GDP growth forecast is a robust 2.5 % in 2017, but should slow over the medium term. Consumers and businesses have both undergone major deleveraging but debt is still high by historical standards. While improving, unemployment remains high and this, coupled with further fiscal retrenchment, could limit growth in household consumption over the medium term.

Commercial Real Estate in Spain

Investment volume in 2016 reached € 8.56 billion, 9 % lower than 2015. The political situation in Spain with the absence of government during the first 10 months of the year and the lack of product on sale have led to a slight reduction of the investment in the Spanish real estate market in 2016.

Offices and retail continued as the main sectors in terms of volume. Offices registered € 2.8 billion, 33 % of the total investment. There is an increasing appetite for the Madrid office market due to the opportunity that Madrid might become the new financial centre in Europe replacing London. Activity was skewed by Pontegadea's purchase of Torre Cepsa for € 490 million of the total. While there is capital waiting to deploy in Spain, both Barcelona and Madrid are suffering from a lack of quality office space and could see yields sharpen over time as competition intensifies. Due to the lack of investment during the crisis, the landlords are focusing today on refurbishments to obtain high quality spaces demanded by the tenants. In this way, there are 3 refurbished buildings in AZCA office area: Castellana 79, Castellana 81 and Torre Europa.

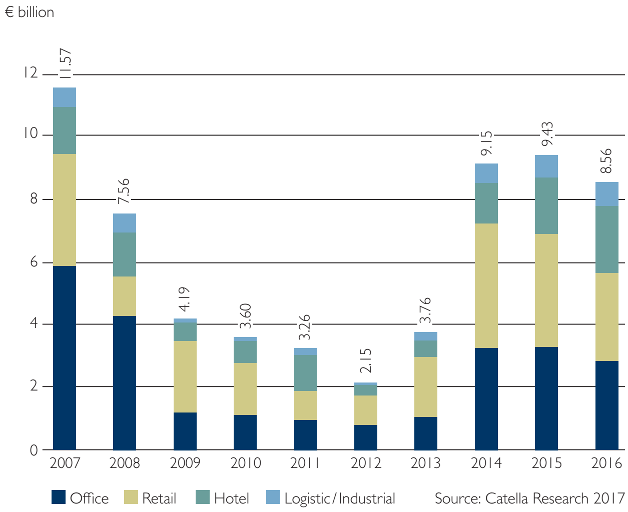
Retail accounted for € 2.8 billion, 33 % of the total. The ongoing economic recovery coupled with booming tourism – nearly 75 million international visitors to Spain – is having a positive impact on retail market. There is a clear focus on well-positioned shopping centres all over Spain and high street retail primarily in Madrid and Barcelona. Deutsche Bank's € 495 million purchase of Diagonal Mar shopping centre in Barcelona was the marquee deal of the year. There is also growing interest in non prime assets, applying downward pressure on secondary yields. In this way, Catella advised Amundi and Pradera on the sale of Travesía Shopping Centre in Vigo for € 49 million. General outlook for retail property in Spain is positive, with steady economic growth and political situation almost settled occupier and investor demand for retail assets is expected to increase.

Logistics gathered € 754 million, 9 % of the total. The endemic low availability of core assets will continue to hamper trading volumes and while prime yields are currently at 6 % in Madrid and Barcelona they will sharpen as competition intensifies. There is a significant interest for logistics assets from institutional investors. In this way, Catella advised the German fund Invesco on the sale of a logistics warehouse located in Quer (Madrid-Barcelona corridor), acquired by the American fund GreenOak. The short term prospects for the market are relatively positive, supported by the robust economy and a further strengthening in demand for quality schemes. Barcelona is likely to fair better where the demand and supply fundamentals are more in balance, unlike Madrid where oversupply will remain a feature for some time.
The most important deal in the last months was the sale & leaseback of Mango logistics centre in Barcelona for € 150 million acquired by the Belgian group VGP.

Hotels registered € 2.2 billion, 25 % of the total investment. International investors have been the most active players with acquisitions mainly in Madrid, Barcelona, Canary and Balearic Islands. The most important deal has been the recent sale by Merlin Properties of a 19 hotels portfolio for € 535 million to the French group Foncière des Régions.

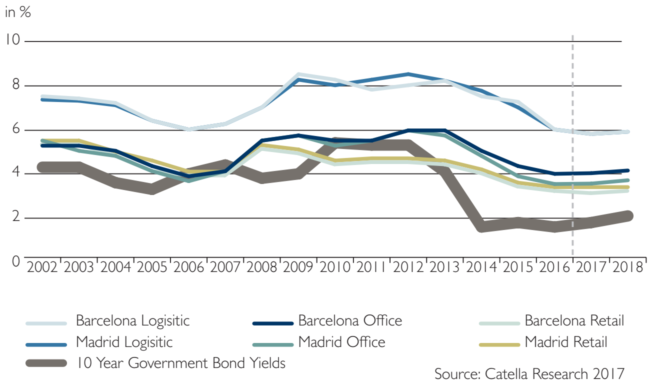
Due to the low interest rates, net yields continue attractive, showing a minimum spread of 200 bps vs. the 10-year government bond yield.

FIG. 3: COMMERCIAL TRANSACTION VOLUME SPAIN



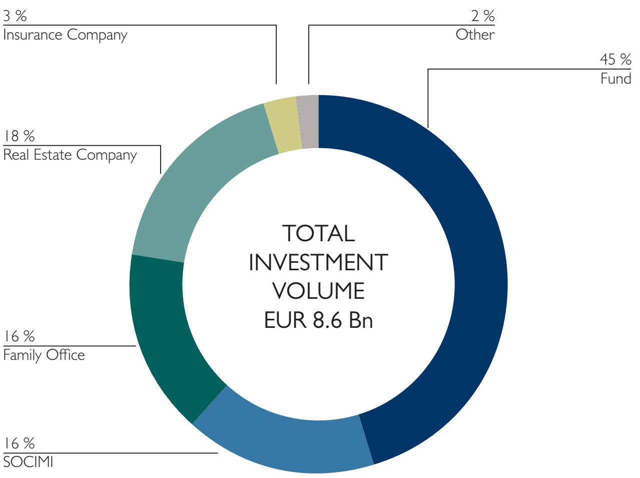
Source: Catella Research 2017

FIG. 4: SPANISH PRIME NET YIELDS VS. GOVERNMENT BOND YIELD



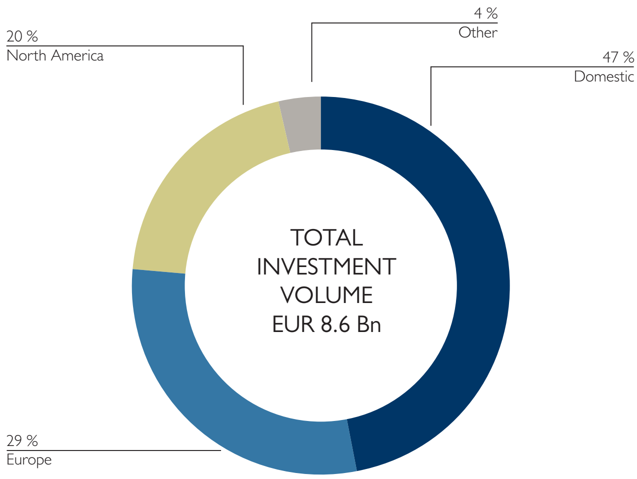
Source: Catella Research 2017

FIG. 5: INVESTMENT VOLUME BY TYPE OF INVESTOR – 2016



Source: Catella Research 2017

FIG. 6: INVESTMENT VOLUME BY ORIGIN – 2016



Source: Catella Research 2017

By type of investor, funds are the most active players in the Spanish market, registering 45 % of the total volume. SOCIMIs, the main players in 2015, reduced its share to 16 %. After 2 years of bustle activity, the 4 biggest SOCIMIs are focusing on specific sectors. Hence, Merlin has just sold its hotel portfolio and AXIARE emphasized its office sector expertise.

The market cycle moved from 2013 – 2014 with opportunistic investors towards 2015 – 2016 with value-add/core+ investors. Opportunistic investors are making the exit with significant returns such as Oaktree with the sale of Gran Vía Shopping Centre in Vigo, acquired in 2014. Additionally, core investors have come back to the market with aggressive purchases of prime assets in Madrid and Barcelona. In this way, the insurance company Catalana Occidente bought the office building Castellana, 55 for € 60 million.

In terms of origin, domestic players imply 47 % of the total volume, considering the SOCIMIs as local investors. Other domestic players apart from SOCIMIs were Colonial and Meridia Capital. Investors from Germany were the strongest buyers from Europe with a total of € 697 million, followed by UK (€ 674 million) and France (€ 646 million). Investors form North America registered approx. € 1.65 billion. The largest transaction was the sale of Eroski-Hypermarkets Portfolio to Invesco for € 358 million.

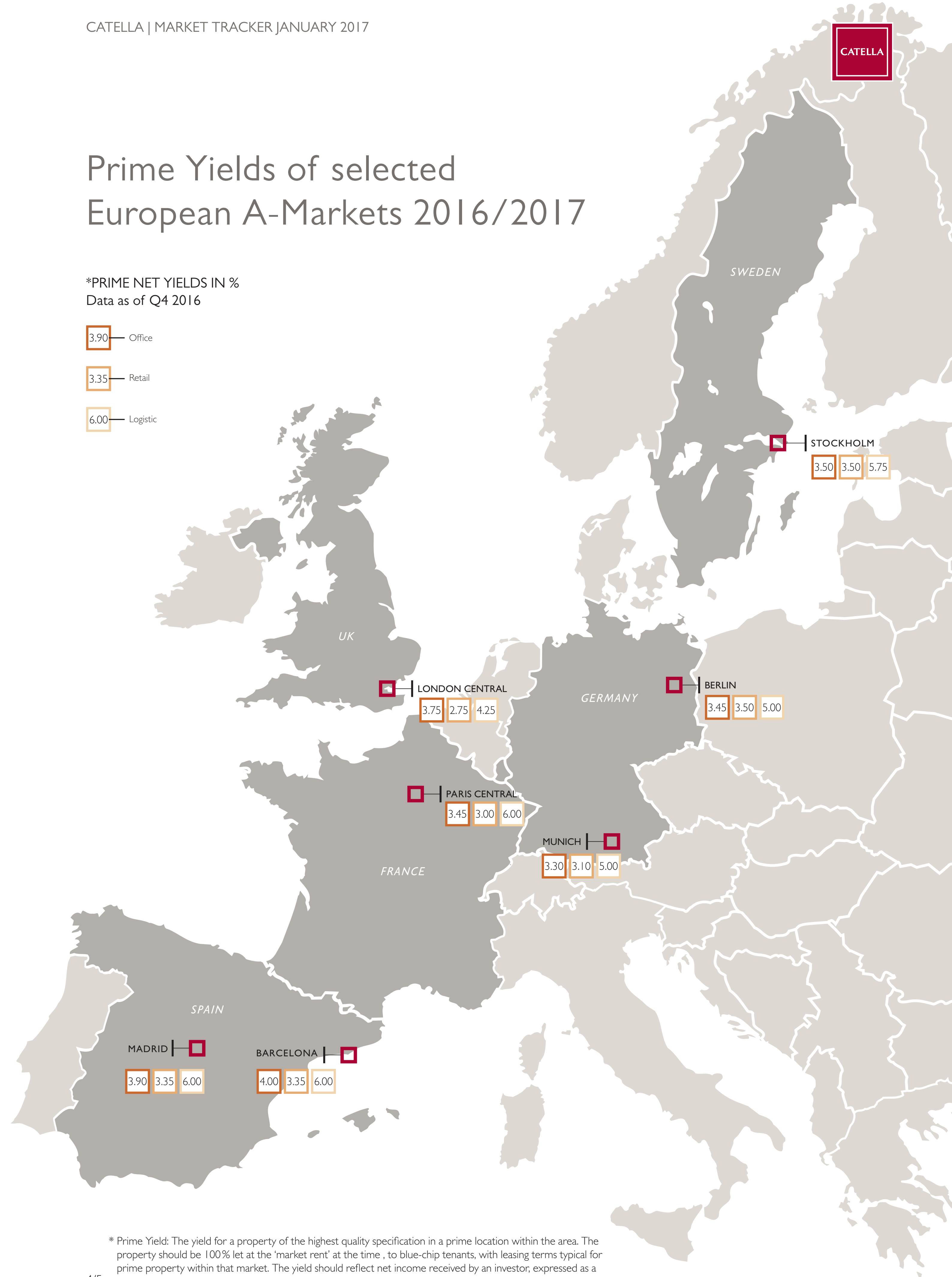
TAB. 2: TOP TRANSACTIONS CRE – 2016

TYPE	MARKET	PROPERTY NAME	AREA IN SQM	PRICE IN EUR M	BUYER	SELLER
Retail	Barcelona	Diagonal Mar Shopping Centre	60,400	495	Deutsche Bank	Northwood Investors
Office	Madrid	Torre Cepsa	72,312	490	Pontegadea	Bankia
Office	Madrid	Adequa	107,000	390	Merlin Properties	Lone Star
Retail	Diverse Portfolio (Spain)	Portfolio of 11 hypermarkets (Euskadi & Navarra)	136,000	358	Invesco Real Estate	Inmobiliaria Gonuri Harizartean
Retail	Madrid	Retail unit (El Corte Ingles)	17,500	150	Monthisa	El Corte Ingles
Logistics	Barcelona	Mango Logistics Centre	180,000	150	VGP Group	Mango

Source: Catella Research 2017

Prime Yields of selected European A-Markets 2016/2017

*PRIME NET YIELDS IN %
Data as of Q4 2016



* Prime Yield: The yield for a property of the highest quality specification in a prime location within the area. The property should be 100% let at the 'market rent' at the time , to blue-chip tenants, with leasing terms typical for prime property within that market. The yield should reflect net income received by an investor, expressed as a percentage of total capital value plus expected acquisition costs.

Source: Catella Research 2017

Catella`s perspectives for 2017

The expansionary phase is expected to continue in 2017 and 2018, with domestic demand leading the recovery, albeit at a slower pace as some factors that have contributed to boost consumption, such as low oil prices and lower taxes, will recede. Inflation will gradually pick up as the effects of low oil prices diminish, but pressures will remain moderate due to still high unemployment.

Positive office rental growth is expected in the city centres of Madrid and Barcelona due to the lack of supply. Investor appetite is strong for office core assets. Yields will remain stable. Rents in retail sector are under upward pressure and yield compression should continue in secondary properties, with subsequent rise in capital values that may prompt further product to come to the market. Given the very low interest rates, the spread between Spanish government bond yields and yields offered by the real estate sector should continue to remain wide for at least the next two years, particularly given the ECB's monetary policy framework. Despite the fact that 2016 started out with investors being more pessimistic about the economy and events should be followed closely to see how this will evolve, we believe that Spanish real estate fundamentals remain robust, hence we expect that 2017 will be a good year for the Spanish real estate sector. We expect a similar investment volume in 2017, having troubles to close deals due to the lack of product in the market. Thus, investors will continue to invest in development projects and refurbishments.

Catella is a leading financial advisor across Europe and asset manager for the areas of property, fixed-income and equity. We occupy a leading position in the real estate sector, with a strong local presence in Europe with around 500 employees across 12 countries.

Your contacts

Spain:
Pablo Carvajal
Head of Capital Markets
Fortuny, 39 - 1ª Planta
ES-28010 Madrid
pablo.carvajal@catella.es
+34 (0)91 411 74 96

Álvaro Martín Simo
Capital Markets
Fortuny, 39 - 1ª Planta
ES-28010 Madrid
alvaro.martinsimo@catella.es
+34 (0)91 411 74 96

Gemany:
Dr. Thomas Beyerle
Head of Group Research
Mainzer Landstr. 46
60325 Frankfurt
thomas.beyerle@catella.de
+49 (0)69 31 01 930 - 220

Andreas Slupik
Research Analyst
Bleichstr. 8 – 10
40211 Dusseldorf
andreas.slupik@catella.de
+49 (0)211 527 00-235